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SUBJECT: MAQUILA ASSOCIATION WARNS OF LOSING COMPETITIVENESS

REF: MEXICO 1841

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¶1. Summary. With the economic crisis and falling oil revenue impacting Mexico's federal budget, maquila owners are concerned that federal lawmakers will raise taxes on their industry to increase government revenue. John Castany, President of the Nuevo Leon Maquila Association, told EconOff on July 17 that any tax increases will make Mexican maquilas less competitive than manufacturers in China and other developing countries. End summary.

Maquilas Reeling from Economic Crisis

¶2. The maquila industry represents the second largest source of foreign currency for Mexico behind petroleum sales. The worldwide economic crisis has taken a damaging toll on the industry; revenues were down 37% in the first quarter of 2009 when compared with the previous year. Castany does not expect the economy to start improving until sometime in 2010. To help weather the downturn, he points out that labor unions have worked positively with manufacturers, allowing them to cut hours and benefits for workers. Conversely, companies have received little aid from the federal government, despite requesting assistance to prevent layoffs. Moreover, GoM aid promised is mainly targeted towards the automotive industry, excluding many other sectors such as electronics and durable household goods.

Tax Uncertainty Looming Over Maquilas

¶3. To increase tax revenue immediately, Castany stated that PRI lawmakers have explored raising taxes on maquilas. Instead of income taxes, Maquilas normally pay a preferential tax based on their fixed assets or operational costs and not income taxes. In a presidential decree issued by former President Fox in 2003, the tax rates were lowered by over 50% until 2011. By raising taxes on maquilas earlier than 2011, lawmakers may be able to avoid imposing unpopular value added taxes on food and pharmaceutical goods in order to balance their budget.

¶4. In addition to the general tax increase, lawmakers are considering a prohibition on "virtual exportations," which allow maquilas to source goods locally. When maquilas were originally established, goods were imported from companies abroad, assembled in Mexico and then re-exported. As part of a

concerted effort to build up the national supply chain, the GoM allowed maquilas to source tax exempt supplies and equipment nationally by filing importation documents and paying tariffs as if the goods had been imported - a process termed "virtual exportation." Under currently proposed legislation, a portion of these taxes would become refundable, but the reimbursement process would add additional expense and red tape and refunds could take up to three months.

15. Legislators also may decide to revoke the maquila exemption from the corporate flat tax (IETU) that other Mexican companies must pay. In early 2008, the National Council of Maquiladora and Export Manufacturing Industry (CNIMME), won concessions from the GoM that allows them to hold off on paying the IETU until 2011 when congress will revisit the issue. If the exemption is eliminated, it will increase the maquilas' overall tax burden and investment risks because of the way the IETU is structured. IETU tax exaggerates the effects of an economic recession such as the one Mexico is currently facing since the IETU taxes gross revenue with very few deductions allowed for cost - i.e. companies will have to pay taxes even if they are operating at a loss for the year since the tax.

More Than Taxes Hindering Industry

16. Castany added that taxes are just part of the competitiveness problems that Mexico faces. CNIMME's agenda for 2009 includes addressing bureaucratic hurdles, outdated labor laws, high electricity costs, poor infrastructure, telecommunications problems, and education (especially bilingual training). For example, employers are required to pay salaries

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and bonuses in cash, creating a security risk for the company and its employees given rising crime rates. Statutes that require companies to provide employees three months of severance plus 20 days for each year of service if they are laid off have been a disincentive to hiring new employees. Interestingly, Castany said that narco related violence is not a major concern for the maquila association at this time. (Note: Mexico's ability to compete has dropped in recent years. In 2008, the World Economic Forum competitiveness survey ranked Mexico 60 out of 131 countries surveyed. In 2000, Mexico was number 32. End note.)

17. Comment. With the PRI now formulating a legislative agenda strongly focused on economic relief, maquila association members feel they will become an early target in an effort to increase GoM tax revenues. Export driven maquilas, however, have already suffered huge losses because of the global recession - which has impacted Mexico worse than most economists have forecast. The new congress' handling of the maquilas tax and competitiveness concerns could be a preview of its ability to tackle larger fiscal reform issues. End Comment.
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